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ASB meeting minutes, 2004, February 24-25; Auditing Standards Board approved highlights, 2003, February 24-25, meeting

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AUDITING STANDARDS BOARD (ASB) MEETING
February 24-25, 2004
Tempe, AZ
Approved Highlights

MEETING ATTENDANCE

ASB Members

John Fogarty, Chair
Harold Monk, Jr., Vice Chair
Barton Baldwin
Gerald Burns
Craig Crawford
George Fritz
James Goad
Lynford Graham
Auston Johnson
James Lee II
Wanda Lorenz
Susan Menelaides
William Messier, Jr.
Daniel Montgomery
Diane Rubin
Mark Scoles
Scott Seasock
Michael Umscheid

Absent: Dan L. Goldwasser

AICPA Staff

Chuck Landes, Director, Audit and Attest Standards
Gretchen Fischbach, Technical Manager, Audit and Attest Standards

Observers and Other Participants

Julie Anne Dilley, PricewaterhouseCoopers, LLP
Robert Dohrer, McGladrey & Pullen, LLP
Diane Hardesty, Ernst & Young, LLP
Cheryl Hartfield, Practitioner's Publishing Company
Maria Manasses, Grant Thornton, LLP
Christopher Schellhorn, Capital Confirmation (February 24)

CHAIR AND STAFF REPORTS

J. Fogarty and C. Landes provided updates on matters relevant to the ASB.

AGENDA ITEMS PRESENTED AT MEETING

Joint Quality Control Standards Task Force

Craig Crawford, Chair of the Joint Quality Control Standards Task Force (task force), led the ASB in a discussion of a revised draft of *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, dated January 5, 2004. The objective of this session was to familiarize the new ASB members with the Guide, to discuss the task force's direction and changes to the Guide, to gather feedback from the ASB as to whether they agree with the views expressed in the Guide, and to identify any weaknesses in the Guide.

The revised draft indicates that it does not address the quality-control ramifications of the Sarbanes-Oxley Act (SOA) and that sections of the Guide that specifically relate to public companies have been deleted. Firms auditing public companies are directed to the SOA and encouraged to become familiar with it and make changes to their firm's quality control system as necessary.

During the meeting, the ASB recommended that:

- The Guide be sent back to the task force for final approval by March 31, 2004. (A task force conference call has been scheduled for March 16, 2004)
- After issuing the Guide, the task force review the *International Quality Control Standard, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*, issued by the International Auditing and Assurance Standards Board in February 2004 to determine if there are items in that standard that should be included in the Guide.
- The Guide include examples of quality control documents.
- The task force consider addressing issues related to partner rotation for a firm that has only one practitioner.

Risk Assessments

John Fogarty, chair of the Joint Risk Assessments Task Force (task force), a joint effort of the International Auditing and Assurance Standards Board (IAASB) and the ASB, provided the ASB with a history of the project and a plan for its completion. On December 2, 2002 the ASB issued an exposure draft of a suite of seven proposed Statements on Auditing Standards (SASs) relating to the auditor's risk assessment process. The exposure draft consists of the following proposed SASs:

- *Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards*
- *Audit Evidence*, which would supersede SAS No. 31, *Evidential Matter* (AU sec. 326)

- *Audit Risk and Materiality in Conducting an Audit*, which would supersede SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AU sec. 312)
- *Planning and Supervision*, which would supersede “Appointment of the Independent Auditor” (AU sec. 310), and SAS No. 22, *Planning and Supervision* (AU sec. 311)
- *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Assessing Risks)*
- *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, which would supersede SAS No. 45, *Substantive Tests Prior to the Balance-Sheet Date* (AU sec. 313), and, together with the proposed SAS *Assessing Risks* would supersede SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit* (AU sec. 319)
- *Amendment to SAS No. 39, Audit Sampling*

The primary objective of the proposed SASs is to enhance the auditor’s application of the audit risk model in practice by requiring:

- A more in-depth understanding of the entity and its environment, including its internal control, that would better enable the auditor to identify the risks of material misstatement in the financial statements and any steps the entity is taking to mitigate them.
- A more rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.
- A better linkage between the assessed risks of material misstatement and the nature, timing, and extent of audit procedures performed in response to those risks.

In October 2003, the IAASB completed the international phase of the risk-assessment project by issuing the following three International Standards on Auditing (ISA):

- ISA 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- ISA 330, *The Auditor's Procedures in Response to Assessed Risks*
- ISA 500, *Audit Evidence*.

The objective of the ASB’s February 24 discussion was to determine what actions should be taken to complete the revision of the standards addressed in the exposure draft. The ASB recommended that:

- The Risk Assessments Task Force be reformed.
- The exposure draft be updated to reflect:
 - Certain changes made to the ISAs
 - Certain aspects of the Public Company Accounting Oversight Board’s auditing standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*
 - Material pertaining to governmental entities
- A summary of the major changes to the risk-assessment standards be included in the SASs.
- The AICPA launch a comprehensive communication effort to make practitioners aware of changes to the standards and how they should be implemented in audits of financial statements.

- Interpretive materials be developed to help practitioners implement the revised standards. (A suggestion was made to integrate the risk assessment material in the Internal Control Guide which is to be revised)
- That the revised standards be effective for fiscal years beginning December 15, 2005.

Specialists Task Force:

M. Umscheid, chair of the specialists task force (task force) presented this matter to the ASB. M. Umscheid informed members that during 2003 the ASB had accepted the task force's recommendation to develop guidance to amend or replace SAS No. 73, *Using the Work of a Specialist*. That guidance would address the following two distinct uses of specialists:

- The auditor hires an outside (non-firm) specialist to provide special skills or knowledge that are needed during the audit but not available on the engagement team
- The auditor uses as audit evidence the workproduct of a nonemployee specialist hired by management

M. Umscheid then led the ASB's discussion of some proposed guidance and several issues the task force identified during the development of the guidance. The ASB took the following actions regarding the issues discussed:

1. With respect to the auditor's use of a specialist to assist during an audit:
 - Directed the task force to consider whether the auditor's core competencies include complex audit/accounting areas such as the ability to evaluate complex accounting provisions relating to assertions about certain types of derivative financial instruments. If so, guidance on the use of a specialist to assist in the audit would apply only to individuals or firms with special skills or knowledge in *other than* audit or accounting. If not, the task force should ensure that the guidance it develops cannot be interpreted to apply to individuals with basic skills in audit/accounting.
 - If the task force concludes that the specialist's skills or knowledge can be in certain highly specialized/complex areas of audit or accounting, the task force should specifically require this individual to be a member of the audit engagement team.
 - Agreed with the task force's proposal to identify the nonfirm specialist as an outside specialist.
 - Recommended reinstating footnote 3 of SAS No. 73.
2. The auditor's use as audit evidence of the work of management's nonemployee specialist
 - Directed the task force to consider whether an industry accountant's core competencies include complex accounting areas. If so, guidance on evaluating the work of management's nonemployee specialist would apply only to individuals or firms with special skills or knowledge in *other than* accounting. If not, the task force should ensure that the guidance it develops cannot be interpreted to apply to individuals with basic skills in accounting.

- Approved excluding from the scope of the standard management's employees with special skills or knowledge.
- Approved the task force's recommendation to require the auditor to evaluate the entity's ability to control or significantly influence the specialist's findings.
- Asked the task force to consider whether a relationship between a specialist and an outside director should be considered when assessing the specialist's objectivity.
- Supports the proposed documentation requirements and recommends also requiring documentation of the basis for the auditor's conclusion that a nonemployee specialist falls within the scope of the SAS.
- Approved the task force's recommendation to require the auditor to evaluate the *reasonableness* of the specialist's assumptions and the appropriateness of the specialist's methods. However, the task force should consider whether certain specialists' work should be excluded from the requirement to evaluate the assumptions. The evaluation of the reasonableness of the assumptions enables the auditor to evaluate the reasonableness of the specialist's findings.

Auditor's Reports

John Fogarty led a general discussion of some of the requirements of ISA 700 "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements." The ISA will be used by the ASB's Auditor's Report Task Force when it begins considering potential revisions to SAS No. 58.